

Study H-820

January 24, 2001

First Supplement to Memorandum 2001-18**Mechanic's Liens: Homeowner Relief Recovery Fund**

Prof. J. Clark Kelso plans to attend the February meeting to present his Homeowner Relief Recovery Fund proposal.

Attached to this supplement is Prof. Kelso's overview of the proposal and a new draft that combines some substantive revisions from his most recent draft (attached to the Third Supplement to Memorandum 2000-78, at the December 2000 meeting) with the staff's formatting and technical revisions (which were in the draft attached to the Second Supplement to Memorandum 2000-78 at the December 2000 meeting). As a consequence of this process, troublesome provisions such as the per payment and lifetime limitations on reimbursement are not in the draft.

The Institute for Legislative Practice draft is available on the Internet at the McGeorge Law School site, under the heading "California Law Revision Commission Submissions" at the following URL:

<http://12.2.169.205/government_law_and_policy/publications/index.htm>

Respectfully submitted,

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Assistant Executive Secretary

HOMEOWNER’S LIEN RECOVERY ACT PROPOSAL

☞ **Staff Note.** This draft is a modified version of the “Homeowner’s Relief Recovery Act” materials submitted by Prof. J. Clark Kelso and the Institute for Legislative Practice. For the most recent draft from the Institute for Legislative Practice, see the Third Supplement to Memorandum 2000-78. This draft is a revised version of the draft attached to the Second Supplement to Memorandum 2000-78. The textual overview starting on the next page is copied from the McGeorge website; it has been reformatted for this document, but has not been further edited.

The staff has revised some section numbers and made other editorial revisions to conform, in part, to Commission drafting style. Additional revisions were necessary because the term “claimant” appear to have been used to refer to both the homeowner and the lienholder. The term “prime contractor” has been substituted for “original contractor” for consistency with an earlier Commission decision. Other definitions have been revised from the original proposal to avoid using terms in the general mechanic’s lien statute that have a different meaning in this statute. If the Commission decides to pursue this proposal, we would provide Comments and make additional technical changes.

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MECHANICS' LIENS AND DOUBLE-PAYMENT BY HOMEOWNERS: A PROPOSAL FOR REFORM¹

by

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(December 2000)

1 Section 3 of Article XIV of the California Constitution provides for mechanics
2 liens as follows:

3 Mechanics, persons furnishing materials, artisans, and laborers of every class,
4 shall have a lien upon the property upon which they have bestowed labor or
5 furnished material for the value of such labor done and material furnished; and the
6 Legislature shall provide, by law, for the speedy and efficient enforcement of such
7 liens.

8 Various provisions of the Civil Code provide for creation and enforcement of
9 mechanic's liens and govern payment provisions contained in contracts for works
10 of improvement to real property. Civ. Code §§ 3109-3154.

11 The mechanic's lien law may operate to the detriment of an innocent homeowner
12 who may, in effect, be required to pay twice for the same work. For example, the
13 situation may arise where a homeowner or residential land improver executes a
14 contract with a general contractor to make an addition to a home or improve a
15 vacant lot. Often, the homeowner will agree to pay the general contractor in full
16 for all services to be performed upon his or her land. The general contractor then
17 hires subcontractors, laborers and materialmen to make the required
18 improvements. In some instances, the general contractor may fail to pay these
19 persons for the value of their work. These persons, under California law, have the
20 right to place a lien upon the improved property, which forces the homeowner,
21 whose property is encumbered, to pay twice or forfeit his or her land to satisfy the
22 lien. Under current law, the homeowner may not interpose, as a defense, the fact
23 that the homeowner already has paid the full contract price to the general
24 contractor.

25 Existing law provides that the amount of a mechanic's lien shall be for the
26 reasonable value of the labor, services, equipment, or materials furnished or for the
27 price agreed upon, whichever is less, but that any original contractor or
28 subcontractor may recover only such amount as may be due under the terms of a
29 contract, after deducting all claims of other claimants for labor, services,
30 equipment, or materials furnished and embraced within the contract. Existing law
31 authorizes the owner of property to petition the proper court for an order to release
32 the property from the lien if specified conditions are met.

1. This overview is taken verbatim from the Institute for Legislative Practice website at McGeorge Law School, under the heading "California Law Revision Commission Submissions" at the following URL: <http://12.2.169.205/government_law_and_policy/publications/index.htm>.

1 Several proposals to protect the homeowner from the burden of paying twice for
2 the same work have been circulated for consideration. There are difficulties with
3 each of these proposals, both political and practical, which have been noted at
4 recent meetings of the California Law Revision Commission on this topic.

5 In an effort to assist the Commission and the Legislature in their consideration of
6 this issue, we propose an alternative solution to the problem of double-payment by
7 homeowners. As we see it, the double-payment problem is best approached
8 through an insurance-type program. Under current law, most homeowners are at
9 risk of a double-payment situation, although most homeowners are either unaware
10 of the risk or willing to take that risk in order to avoid the costs of protecting
11 themselves against it. In an idealized world, an enlightened homeowner who
12 wished to avoid the risk of a mechanics' lien would purchase insurance against
13 such a risk (or would self-insure). Then, if a mechanic's lien is placed upon the
14 property because of non-payment by the general contractor, and the owner has
15 already paid the general contractor, the lien holder could be paid from the
16 insurance funds, resulting in the lien being discharged.

17 Assemblyman Honda's proposal during the 1999-2000 legislative session (AB
18 2113) seems to recognize the insurance-like nature of the problem. AB 2113
19 proposed creating a Contractor Default Recovery Fund ("CDRF") which would be
20 used to satisfy claims of non-payment by sub-contractors who provide labor,
21 service, equipment, or material to an improvement on residential property. This
22 would protect homeowners who have already paid a general contractor from
23 having to pay a sub-contractor to satisfy the lien obligation.

24 Although AB 2113 was intended to protect homeowners, it proposed to finance
25 the CDRF by initially imposing a \$200 annual fee upon licensed home
26 improvement contractors and giving the Contractors' State License Board the
27 responsibility for recommending adjustments to the fee to meet the projected
28 claims over the next year.

29 On first glance, it is arguably appropriate to finance the CDRF from fees paid by
30 home improvement contractors since those contractors, as well as home owners,
31 stand to benefit from creation of the CDRF. However, under current law, home
32 improvement contractors already have a potent weapon to collect payments
33 through the lien law, a weapon that has constitutional support. Thus, from the
34 perspective of home improvement contractors who are comparing AB 2113 with
35 existing law, AB 2113 increases the cost of doing business without creating
36 significantly greater security for payment than currently exists. Moreover, it is not
37 at all clear that the burden of additional fees would actually weigh equally upon all
38 contractors. For example, sub-contractors who have established long-standing,
39 stable relationships with general contractors and who may never face the problem
40 of non-payment will be required to pay the same fee as sub-contractors who are at
41 a much greater risk of non-payment.

42 Arguably, since AB 2113 would impose the identical fee upon all home
43 improvement contractors, the increased costs would ultimately be borne, at least in

1 some measure, by homeowners (since subcontractors would attempt to pass the
2 increased cost to general contractors who, in turn, would attempt to pass the
3 increased cost to homeowners). Since the primary benefit of AB 2113 is to
4 homeowners (compared to existing law), it is appropriate that homeowners be
5 responsible for paying for any statewide insurance program.

6 Our proposal builds upon Assemblyman Honda's AB 2113. As with AB 2113,
7 we propose creation of a fund, called the Homeowner's Relief Recovery Fund
8 ("HRRF"), to be administered by the Contractors' State License Board, which
9 would be used to make payments to sub-contractors or homeowners in situations
10 where the homeowner has already paid the general contractor for work performed
11 by the sub-contractor. The payment would be made after the homeowner files a
12 claim with the Board and it is determined to be valid. Since the primary benefit of
13 the fund is to homeowners, we propose that a modest Homeowner's Lien
14 Protection Fee be added to residential building permit fees. The Homeowner's
15 Lien Protection Fee would be collected by the local jurisdiction at the time a
16 residential building permit is issued and, after a deduction for local expenses
17 associated with collection of the fee, would be forwarded to the State Treasury for
18 deposit in the HRRF.

19 We are not breaking any new ground in proposing that a state fund be financed
20 by fees on building permits. The Strong Motion Instrumentation Program (Pub.
21 Res. Code §§ 2700-2709.1) requires that all persons receiving building permits
22 pay an additional fee, the amount of which is in relation to the total value of all
23 labor and material to be used within a building project. Pub. Res. Code § 2705.
24 Thus, there is already a mechanism for using county and city building permit fees
25 to support a statewide program.

26 As with the Strong Motion Instrumentation Program, we propose funding the
27 Homeowner's Relief Recovery Fund through a small fee added to the fees already
28 charged for the issuance of residential building permits which are issued to the
29 homeowner or land improver. This fee would be a small fraction of the value of
30 the proposed improvement, including the value of all labor and materials used.
31 Under this approach, the cost of protecting homeowners against the risk of double-
32 payment will be borne by homeowners themselves, which is appropriate since they
33 are the ones who most directly benefit from the change in law proposed by this
34 legislation.

35 Because of the uncertainty regarding the exact scope of the double-payment
36 problem, we have not attempted to suggest how large the fee should be to provide
37 sufficient funds for the Homeowner's Relief Recovery Fund to operate properly.
38 However, if a reliable estimate of the yearly costs can be developed, it will be a
39 straightforward process to determine the rate for the fee based upon the funds
40 raised by the Strong Motion Instrumentation Program.

41 The system we propose would operate as follows:

42 Assume that a homeowner contracts with a licensed general contractor for
43 services to add an additional room to his or her home. The homeowner agrees to

1 pay in full for all services performed on the home. The general contractor contracts
2 for services with a subcontractor but does not pay the subcontractor upon
3 completion of the job. Under current law the subcontractor has the right to file a
4 lien against the homeowner for payment of services rendered. The subcontractor
5 would go to the county recorder's office to file a lien against the homeowner.

6 Under the proposed legislation, the county recorder notifies the homeowner of
7 the lien as well as their rights, including a toll free 800 number the homeowner can
8 call to get more information. The homeowner has 90 days from the time the lien is
9 recorded to file a claim under the HRRF. When the homeowner calls the toll free
10 800 number, they receive information on how to file a claim with the HRRF. The
11 Board sends them information and paperwork necessary to file the claim. The
12 homeowner would include documentation as required, such as statements
13 regarding the services performed, proof of payments such as canceled checks,
14 copy of any preliminary notice given by the lien holder and a copy of the lien
15 itself. At that time the claim is opened and filed with the Board.

16 The Board notifies the lienholder and the general contractor of the claim and
17 they have 15 days in which to file a response. The response from the general
18 contractor should include any detail concerning their defense of the claim, if any,
19 and any documents to support the defense. If the general contractor does not
20 respond to the notice, the hearing officer officially determines that the general
21 contractor was paid in full by the homeowner. The value of the claim is
22 determined with the documentation provided and the lienholder is paid.

23 If the general contractor responds, the board sets a hearing date within 60 days
24 near to the site of the work performed. If, at the hearing, the hearing officer
25 determines that the homeowner has not paid the general contractor in full, the
26 claim is dismissed and the lienholder may pursue foreclosure of the lien. If the
27 hearing officer determines that the homeowner paid the general contractor in full,
28 the hearing officer determines the value of the claim and orders the Board to pay
29 the lienholder that amount. In order to receive the payment, the lienholder must
30 file a release of the lien in the county recorders' office. Once the lienholder files
31 the release, the case is closed.

32 No system to resolve payment disputes is guaranteed to work properly every
33 time. We recognize, in particular, that our proposal, which permits payments to be
34 made to a lienholder from a state fund, may create an opportunity for fraud and
35 collusion between a lienholder and homeowner. At this stage in the development
36 of the proposal, we do not have what we consider an entirely satisfactory
37 mechanism for discovering potential fraud. Whether fraud would actually occur
38 under this system is speculative since lienholders and homeowners may be
39 adequately deterred from such conduct by the existing serious consequences that
40 would flow from a discovery of fraud (including criminal sanctions and loss of
41 contractor's license).

1 In light of the complexity of this topic, we are confident that our proposal can be
2 improved upon, and we look forward to receiving criticisms and comments from
3 interested and informed reviewers.

DISCUSSION DRAFT²

4 **Civ. Code §§ 3155-3155.16 (added). Homeowner’s Relief Recovery Act**

5 SECTION 1. Article 8 (commencing with Section 3155) is added to Chapter 2 of
6 Title 15 of Part 4 of Division 3 of the Civil Code, to read:

7 Article 8. Homeowner’s Relief Recovery Act

8 **§ 3155. Short title**

9 3155. This article may be cited as the Homeowner’s Relief Recovery Act.

10 **§ 3155.01. Definitions**

11 3155.01. Unless the provision or context otherwise requires, the following
12 definitions govern the construction of this article:

13 (a) “Board” means the Contractors’ State License Board.

14 (b) “Full payment” or “paid in full” means that the person who provided labor,
15 services, equipment, or material has received compensation equal to its reasonable
16 value. A person is not considered to have been paid in full if 10 percent or more of
17 any retention proceeds have been withheld.

18 (c) “Fund” means the Homeowner’s Relief Recovery Fund established by this
19 article.

20 (d) “Home” means an existing single-family dwelling that is the homeowner’s
21 primary residence.

22 (e) “Homeowner” means the record owner of a home.

23 (f) “Lienholder” means a person not in direct contractual privity with the
24 homeowner, who has recorded a lien under this title and who has not been paid in
25 full.

26 (g) “Prime contractor” means a person who has a direct contractual relationship
27 with the homeowner to provide labor, services, equipment, or material toward a
28 work of improvement on the home.

2. As noted in the First Supplement to Memorandum 2001-18, the draft combines Commission staff technical revisions with substantive revisions made by the authors between the earlier draft attached to Memorandum 2000-47 and the draft attached to the Third Supplement to Memorandum 2000-78.

1 **§ 3155.02. Preconditions to bringing action to foreclose mechanic's lien**

2 3155.02. A lienholder may not commence an action under this title to enforce a
3 lien on a home unless a hearing officer first determines, in a hearing held pursuant
4 to this article, that the following requirements are satisfied:

5 (a) The homeowner hired only a licensed prime contractor pursuant to a written
6 contract.

7 (b) The homeowner has not paid the prime contractor in full.

8 **§ 3155.03. Establishment of fund, limits on recovery**

9 3155.03. (a) There is hereby established within the State Treasury the
10 Homeowner's Lien Recovery Fund, which is hereby continuously appropriated for
11 the purpose of administering this article, including paying the compensation of
12 hearing officers appointed under this article, and providing monetary relief to a
13 lienholder.

14 (b) Except as provided in this article, the state is not liable for any claims against
15 the fund.

16 **§ 3155.04. Requirement of recorded lien**

17 3155.04. In order to establish a claim from the fund, a homeowner shall provide
18 evidence that a lien is recorded against his or her home pursuant to this title.

19 **§ 3155.05. Administration by Contractors' State License Board**

20 3155.05. (a) The board shall administer the fund and shall develop rules and
21 regulations to administer the fund pursuant to this article.

22 (b) The board may file a civil action against any licensed prime contractor in
23 order to obtain reimbursement to the fund for any payments made to a lienholder
24 upon a finding by a hearing officer that the prime contractor failed to pay the
25 lienholder in full.

26 (c) The board shall establish a toll-free telephone number to provide information
27 to all parties concerning the fund, the hearing process, and requirements under this
28 article.

29 **§ 3155.06. Determination and collection of fees**

30 3155.06. (a) Counties and cities shall collect a fee from each applicant for a
31 building permit. The amount of the fee shall be determined by the board.

32 (b) The board shall annually determine whether the fees collected are sufficient
33 to meet the projected claims over the next year and annually report to the
34 Legislature on the need to increase or decrease fees. In making this determination,
35 the board shall exclude in any fund balance moneys in the fund that are
36 encumbered by claims approved pursuant to this article.

37 (c) The board shall annually review and audit the fund.

1 **§ 3155.07. Deposit of fees**

2 3155.07 All fees collected pursuant to 3155.06, except those retained by the
3 local city or county collecting the fee, shall be deposited in the State Treasury in
4 the fund, which is to be used exclusively for the purposes of this article.

5 **§ 3155.08. Extension of lien foreclosure period**

6 3155.08. Notwithstanding [any other provision of law], the time for a lienholder
7 to bring an action to foreclose a lien is extended to 60 days after service of the
8 decision by a hearing officer regarding the homeowner's claim against the fund.

9 **§ 3155.09. Claim against fund**

10 3155.09. Within 90 days after a lienholder has recorded a lien on a home, the
11 homeowner shall file a claim with the board. This claim shall include the
12 following:

13 (a) A copy of any preliminary notice given by the lienholder, together with its
14 proof of service, if a lienholder is otherwise required to serve a preliminary notice.

15 (b) A copy of the mechanic's lien recorded in the office of the county recorder.

16 (c) A statement of account showing all charges, credits, and balance due.

17 (d) Proof of payment including but not limited to a receipt of payment, credit
18 card receipt or statement, or canceled check.

19 **§ 3155.10. Notice of homeowner's claim, response**

20 3155.10. (a) Promptly after the homeowner's claim has been filed with the board
21 under Section 3155.09, the board shall notify the prime contractor and the
22 lienholder of the filing.

23 (b) The prime contractor and lienholder shall file a response within 15 days after
24 receipt of the notice under subdivision (a). The response shall state in detail the
25 defense against the homeowner's claim and include all documents the respondent
26 claims support the defense. If the prime contractor contends that it has not been
27 paid in full, the prime contractor shall provide a copy of all documents in support
28 of this contention.

29 (c) The homeowner, the prime contractor, and the lienholder shall submit any
30 other information to assist the hearing officer to make the determinations required
31 by this article.

32 **§ 3155.11. Default by prime contractor**

33 3155.11. If the prime contractor fails to respond to the homeowner's claim, the
34 hearing officer shall find that the homeowner paid the prime contractor in full and
35 shall determine the value of the claim based on the documentation provided.

36 **§ 3155.12. Hearing date**

37 3155.12. The board shall set a hearing date within 60 days of receipt of the
38 homeowner's claim at the office of the board nearest to the site of the work of
39 improvement before the hearing officer. To the extent possible, all claims

1 submitted on the same project shall be consolidated and heard at the same hearing.
2 The board shall give notice to the parties of the date, time, and location of the
3 hearing.

4 **§ 3155.13. Determinations at hearing**

5 3155.13. (a) At the hearing, the hearing officer shall first determine whether the
6 homeowner has paid the prime contractor in full.

7 (b) If the hearing officer determines that the homeowner has not paid the prime
8 contractor in full, the hearing officer shall dismiss the claim and issue a finding
9 that the lienholder may pursue foreclosure of its mechanic's lien.

10 (c) If the hearing officer determines that the homeowner has paid the prime
11 contractor in full, the hearing officer shall determine the validity and reasonable
12 value of the claim and, if it is determined to be valid, enter an order directing the
13 board to pay the amount of the claim to the lienholder from the fund.

14 **§ 3155.14. Conduct of hearing, qualifications of hearing officers**

15 3155.14. (a) The hearing shall be conducted in accordance with Chapter 5
16 (commencing with Section 11500) of Part 1 of Division 3 of Title 2 of the
17 Government Code.

18 (b) A hearing officer appointed by the board shall be an attorney licensed to
19 practice in this state with at least five years of experience in mechanic's lien law.

20 **§ 3155.15. Obligations of parties**

21 3155.15. (a) The hearing officer's findings are final and impose obligations on
22 the homeowner, prime contractor, and lienholder only to the extent that the
23 homeowner, prime contractor, or lienholder agree to be bound by the obligations.
24 The remedies available to a party under this article, including the right to receive
25 payment from the fund, are not available to a party that does not agree to the
26 obligations. A lienholder is deemed to agree to the obligations only by recording a
27 release of the lien in the county recorder's office where the real property is
28 located. The hearing officer's findings may be entered into evidence in a later civil
29 action or proceeding. The findings of the hearing officer shall be served on the
30 homeowner, the prime contractor, the lienholder, and the board not later than 10
31 days after the hearing.

32 (b) Following receipt of an order pursuant to Section 3155.13, within 10 days
33 after receiving evidence that the lienholder has recorded a release of its lien in the
34 county recorder's office where the real property is located, the board shall pay the
35 amount of the homeowner's claim. The evidence of release shall be submitted
36 within 15 days after the hearing officer's findings are served.

37 **§ 3155.16. Contractor's license suspension**

38 3155.16. A finding by the hearing officer that the prime contractor was paid in
39 full and failed to make timely payments to a lienholder on the work of

1 improvement, except a finding made pursuant to Section 3155.11, is grounds for
2 immediate suspension of the prime contractor's license. The prime contractor shall
3 be given notice of a hearing to challenge the finding, which shall be conducted
4 within 60 days of the date of the suspension, pursuant to the procedures of the
5 board. If the finding is sustained, the prime contractor's license shall be
6 immediately revoked and may not be reinstated until the prime contractor can
7 supply to the board a license bond as provided in Section 7071.8 of the Business
8 and Professions Code in the amount of fifty thousand dollars (\$50,000).

9 **§ 3155.17. Forms**

10 3155.17. (a) The board shall adopt forms required under this article and make
11 them available to the parties.

12 (b) The county recorder shall provide information pursuant to subdivision (c) of
13 Section 3155.05 at the time notice is sent to an owner of property on which a lien
14 is recorded.

15 **Uncodified (Crime)**

16 SEC. 2. Any firm, corporation, partnership, or association, or any person acting
17 in his or her individual capacity who aids, abets, solicits, or conspires with any
18 person to knowingly present or cause to be presented any false or fraudulent claim
19 for the payment of a loss under the provision of this act is guilty of a felony
20 punishable by imprisonment in the state prison for two, three, or five years, and by
21 a fine not exceeding fifty thousand dollars (\$50,000), unless the value of the fraud
22 exceeds fifty thousand dollars (\$50,000) in which event the fine may not exceed
23 double of the value of the fraud.

24 ☞ **Staff Note.** The crime provision should be codified, not uncodified.

25 **Uncodified (Reimbursement)**

26 SEC. 3. No reimbursement is required by this act pursuant to Section 6 of Article
27 XIII B of the California Constitution for certain costs that may be incurred by a
28 local agency or school district because in that regard this act creates a new crime
29 or infraction, eliminates a crime or infraction, or changes the penalty for a crime or
30 infraction, within the meaning of Section 17556 of the Government Code, or
31 changes the definition of a crime within the meaning of Section 6 of Article XIII B
32 of the California Constitution.

33 However, notwithstanding Section 17610 of the Government Code, if the
34 Commission on State Mandates determines that this act contains other costs
35 mandated by the state, reimbursement to local agencies and school districts for
36 those costs shall be made pursuant to Part 7 (commencing with Section 17500) of
37 Division 4 of Title 2 of the Government Code. If the statewide cost of the claim
38 for reimbursement does not exceed one million dollars (\$1,000,000),
39 reimbursement shall be made from the State Mandates Claims Fund.